No. 87-348

Supreme Court, U.S.
FILED
OCT 6 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

PHILLIPS PETROLEUM COMPANY,
Petitioner,

v.

IRL SHUTTS and ROBERT ANDERSON and BETTY ANDERSON, individually and as representatives of all producers and royalty owners to whom Phillips Petroleum Company made payment of suspended proceeds of royalties pursuant to Federal Power Commission Opinion Nos. 699, 699H, 749, 749C, 770 and 770A,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of Kansas and Petition for Writ of Mandamus

REPLY OF PHILLIPS PETROLEUM COMPANY

ARTHUR R. MILLER
1545 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4111

JOSEPH W. KENNEDY *
ROBERT W. COYKENDALL
MORRIS, LAING, EVANS, BROCK & KENNEDY, Chartered
Fourth Floor, 200 West Douglas
Wichita, Kansas 67202
(316) 262-2671

WILLIAM G. PAUL
JOHN L. WILLIFORD
T. L. CUBBAGE II
MICHAEL RIGGS
Phillips Petroleum Company
1256 Adams Building
Bartlesville, Oklahoma 74004
(918) 661-7026

Attorneys for Petitioner Phillips Petroleum Company

* Counsel of Record

Date: October 6, 1987

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
I. The Kansas Supreme Court Failed To Follow This Court's Mandate	1
II. The Kansas Court Created Federal Common Law	4
III. The Respondents' Uniform Equitable Doctrine Offends Constitutional Protections	5
CONCLUSION	9

TABLE OF AUTHORITIES

Cases: Page

Baker Marine Corp. v. Weatherby Engineering Co., 710 S.W.2d 690 (Tex. App. 1986) ---- 3
Close v. Fields, 13 Tex. 623 (1855) ---- 3
Missouri-Kansas-Texas Railroad Co. v. Fiberglass Insulators, 707 S.W.2d 943 (Tex. App. 1986) ---- 3
Phillips Petroleum Co. v. Stahl Petroleum Co., 569 S.W.2d 480 (Tex. 1978) ---- 3
Sid Richardson Carbon & Gas Co. v. Phillips Petroleum Co., 456 F.2d 203 (5th Cir. 1972) ---- 3
Shutts, Executor v. Phillips Petroleum Co., 222 Kan. 527, 567 P.2d 1292, *cert. denied*, 434 U.S. 1068 (1978) ---- 2
Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980) (plurality opinion) ---- 7
Watkins v. Junker, 90 Tex. 584, 40 S.W. 11 (1897) ---- 3
Wortman v. Sun Oil Co., 241 Kan. 226, 734 P.2d 1190 (1987) ---- 7

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-348

PHILLIPS PETROLEUM COMPANY,
Petitioner,

v.

IRL SHUTTS and ROBERT ANDERSON and BETTY ANDERSON, individually and as representatives of all producers and royalty owners to whom Phillips Petroleum Company made payment of suspended proceeds of royalties pursuant to Federal Power Commission Opinion Nos. 699, 699H, 749, 749C, 770 and 770A,
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of Kansas and Petition for Writ of Mandamus

---

REPLY OF PHILLIPS PETROLEUM COMPANY [1]

I. The Kansas Supreme Court Failed To Follow This Court's Mandate.

Respondents, like the court below, refuse to recognize that this Court has determined conclusively that Kansas law substantively conflicts with the law of the other states such as Texas. App. 84a-85a. Respondents, like the court below, fail to recognize this Court's holding

---

[1] Phillips Petroleum Company's statement pursuant to Sup. Ct. R. 28.1 can be found at 175a of the Appendix to Petition for Writ of Certiorari to the Supreme Court of the State of Kansas and Petition for Writ of Mandamus.

that the Kansas court did not follow contrary Texas precedent in *Shutts, Executor v. Phillips Petroleum Co.*, 222 Kan. 527, 567 P.2d 1292 (1977), *cert. denied*, 434 U.S. 1068 (1978). App. 85a, n. 8. Respondents, like the court below, have chosen to treat this Court's prior opinion as if it was silent on the existence of any conflict among the laws relating to interest of the interested states. Respondents, and the court below, believe themselves free to choose any construction of other states' laws unrestrained by the holdings of this Court. This defiant belief must not go unchallenged.

When this case was last before it this Court certainly did not attempt to address and determine each conflict between Kansas law and the laws of other interested states raised by Phillips Petroleum Company (Phillips). This Court determined that applying Kansas law to all transactions violated constitutional constraints; it reached that conclusion only after finding substantial conflicts between Kansas law and the laws of Texas, Oklahoma and Louisiana. App. 86a. This Court left to the Kansas Supreme Court the task of formulating a constitutionally permissible conflict of laws rule and applying the laws chosen pursuant to that rule.

In response to this task, the Kansas Supreme Court chose to examine and purportedly apply the laws of five other states, including states that this Court previously found to have laws that conflict with Kansas law. Having chosen the law of those states as appropriate law, the Kansas Supreme Court should have reached results consistent with this Court's holding as to what that law was. Instead of giving effect to the conflicts on the applicable interest rates and the other conflicts noted by this Court, the court below circumvented these conflicts by distorting the law of each of the interested states to make that law consistent with Kansas law.

Respondents do not attempt to justify the Kansas Supreme Court's most glaring avoidance of other states'

law—the application of FERC interest rates instead of the Texas statutory rate of interest—by citing any Texas authority that allows the FERC rates to be applied.[2] Instead, respondents, like the court below, in effect assert that the Kansas Supreme Court was free to create Texas law, notwithstanding the holding in *Phillips Petroleum Co. v. Stahl Petroleum Co.*, 569 S.W.2d 480 (Tex. 1978), and subsequent cases applying that holding. The argument that *Stahl* has nothing to say about the rate to apply under an "equitable" allowance of interest is absolutely contrary to the Texas Supreme Court's decision in that case. That case recognized that Texas may allow recovery of interest based on an equitable doctrine, but also held that such interest is measured by the statutory rate.[3]

This Court recognized that Kansas law is not consistent with the laws of other states. The respondents here, and the Kansas court below, merely close their eyes to these conflicts, apply Kansas law as if it was consistent

---

[2] Respondents' statement that "in *Sid Richardson Carbon & Gas Co. v. Phillips Pet[roleum Co.]*, 456 F.2d 203 ([5th Cir.] 1972), Phillips was ordered to pay interest on suspense royalties at FERC rates," Resp. Brief in Opposition, p. 9, is a complete fabrication. That case was a dispute between Phillips as seller, and Sid Richardson as purchaser, over the correct interpretation of a gas purchase contract. No "suspense royalties" were involved in that case. The Kansas Supreme Court did not even cite *Sid Richardson* in its decision.

[3] "Nonstatutory interest has been allowed most often under the name of 'damages,' measured by the legal rate of interest . . . ." 569 S.W.2d at 486. "The legal rate of interest is the safest criterion or standard of damages" in such cases." *Id., citing Close v. Fields*, 13 Tex. 623 (1855). "[T]he courts have, by analogy, adopted the legal rate of interest fixed by statute as the standard by which to be governed in assessing damages for the detention of money." *Id., quoting Watkins v. Junker*, 90 Tex. 584, 40 S.W. 11 (1897). Subsequent Texas cases have continued to limit equitable interest in contract cases to the statutory rate. *Missouri-Kansas-Texas Railroad Co. v. Fiberglass Insulators*, 707 S.W.2d 943 (Tex. App. 1986); *Baker Marine Corp. v. Weatherby Engineering Co.*, 710 S.W.2d 690 (Tex. App. 1986).

with the other states' laws and submit that this process is consistent with this Court's mandate. This evasion of the mandate cannot withstand this Court's scrutiny.

II. The Kansas Court Created Federal Common Law.

Respondents' attempt to disentangle the Kansas court's use of the FERC interest regulation from its holding under state laws does little more than support the fact that the Kansas Supreme Court created federal common law.[4] Respondents ignore the Kansas court's holding that abrogated "without interest" contracts[5] on the basis of what the Kansas court found to be a conflict with the federal regulation. Respondents justify the Kansas court's use of this regulation as Polaris, pointing the way for all states to impose interest at federal rates—notwithstanding different statutory rates or constitutional provisions—by fashioning a universal equitable principle that dictates uniform application of the FERC interest rate.

The respondents' creation of this universal equitable principle to justify the Kansas Supreme Court's holding is no less abhorrent to the Constitution than the Kansas

---

[4] Phillips properly presented the "federal common law" question to the Kansas Supreme Court. Phillips, in its motion for rehearing, argued that the federal regulation did not support the imposition of interest at the federal rates; that the federal regulation could not be properly extended to include the royalty obligation; that the federal agency had no jurisdiction to create liability to royalty owners for interest; and that imposing interest liability at federal rates was inconsistent with congressional intent. Although Phillips did not use the expression "federal common law" below, the issue was presented thoroughly to that court.

[5] Phillips entered into "without interest" contracts with a number of producers. These contracts contained a contractual pricing term that required Phillips to pay a price for gas it took calculated upon approved filed rates. If and when any new rate was approved, the contract provided for a recomputation of the purchase price for the period in which Phillips collected unapproved rates and a payment of the recomputed price without interest.

court's creation of federal common law to justify the Kansas result reached below. Either by substituting the federal regulation for analysis of state law, as the court did below, or by expressly creating and applying a universal equitable notion, as advocated by the respondents, the policies of the other states were defeated and displaced by Kansas' notion of what the equitable result should be in this case.

Contrary to what respondents assert, however, there is no question but that the Kansas Supreme Court expressly relied upon the FERC regulation to displace the law of any state that would uphold "without interest" contracts. The Kansas Supreme Court's statement that the additional royalties "are thoroughly permeated with interest fixed by federal law in the FPC regulations . . . ," App. 50a, and that court's holding that those regulations set applicable interest rates, notwithstanding the differences in state law pointed out by Phillips, demonstrate that Kansas in fact did create federal common law. As shown in Phillips' petition, the creation of that law serves to defeat congressional goals and is an unwarranted judicial intrusion into areas that Congress believed would be better governed by regulatory agencies or left to individual state determinations.

III. The Respondents' Uniform Equitable Doctrine Offends Constitutional Protections.

Respondents repeatedly focus not on the law of the interested states, but rather upon their own and the Kansas Supreme Court's notions of "equity." Under the holding below as demonstrated in the respondents' brief, the most "equitable" rates are said to be those producing the highest yield for the royalty owners. Thus, Texas' application of the six percent statutory interest rate, rather than the higher federal rate, is labeled as incon-

sistent with "equitable" principles.[6] Viewed with the advocate's eye from the royalty owners' perspective, "the most equitable interest rate obviously is not the statutory rate." Resp. Brief, p. 8. Those statutory rates are "antique." Resp. Brief, p. 7. By assuming that the highest rate is the most "fair and equitable" rate, respondents are able to conclude that "the statutory rates, some of them enacted in the 1930's, would not be fair and equitable . . ." and that Kansas' choice of the FERC rates "can hardly be said to be 'arbitrary or fundamentally unfair.' . . ." Resp. Brief, pp. 21, 18. Anything that poses impediments to the royalty owners receiving the highest rate constitutes "defenses based on technicalities of laws of other states and alleged constitutional infirmities. . . ." Resp. Brief, p. 4. Respondents naturally agree with the Kansas District Court that the laws of other states that yield lower returns for royalty owners are "less logical [and] fair than the Kansas Supreme Court has been in the *Shutts* case." App. 59a.

Instead of arguing that the Kansas court attempted in good faith to determine and apply the substantive law of the interested states, the respondents argue that the Kansas application of "equitable principles" was of such transcendental fairness that the result should not be upset. Whether Kansas law has produced a result that the respondents, or even the Kansas courts, deem "fair" is beside the point.[7] The universal application of the Kansas

---

[6] The respondents refer to FERC rates of seven and nine percent. Resp. Brief, pp. 4, 8, 20. These figures do not accurately portray the impact that applying the FERC rate has in this litigation. Since October 1, 1979, the FERC rate has been adjusted quarterly and in one quarter even rose above 20 percent. Application of this rate will have a very significant impact on Phillips' liabilities.

[7] The quality of the Kansas judiciary is not at issue. As shown by this Court's reversal of the prior judgment in this case, the Kansas court is not infallible. Given the royalty-owner bias the Kansas court has displayed in the past, the respondents' flattering description of the "quality" of the Kansas judiciary is understandable.

notion of equity has acted to defeat countervailing policies of other states and has resulted in the exaction of interest at much higher rates than would have occurred under a proper application of other states' laws.

When this Court decided this case, it recognized that the constitutional protections of full faith and credit and due process prevent a defendant from being liable under the law of a state having no connection to a transaction. Yet, the process employed by the Kansas Supreme Court achieved exactly that unconstitutional result. Notwithstanding indistinguishable cases reaching contrary results in other states, the Kansas court universally reached the Kansas answer. Kansas' refusal to abide by the law of the interested states is "the very kind of parochial entrenchment on the interests of other states that it was the purpose of the Full Faith and Credit Clause and other provisions of Article IV of the Constitution to prevent." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980) (plurality opinion).

Review should be granted so that the improper extension and misapplication of Kansas law be contained. The result reached below will not be limited to the 28,000 claims of class members in this case. It already has been relied upon in upholding the claims of 3,000 class members in *Wortman v. Sun Oil Co.*, 241 Kan. 226, 734 P.2d 1190 (1987). It undoubtedly will be relied upon to dispose of any other suspense royalty class action cases now pending in Kansas. The process employed by the Kansas Supreme Court to construe the laws of other states to be consistent with the law of Kansas—no matter what—will influence any action filed in Kansas that has a choice of law question. Allowing the decision of the court below to stand only can lead to increased interstate tension [8] and

---

[8] Contrary to respondents' bald assertion that no forum shopping will result, the circumstances surrounding the present case certainly smack of forum shopping. This action had its genesis in an Oklahoma class action brought by Bill Ginder, the senior partner of

an escalation of the risks faced by any corporation that does business in, or is amenable to suit in Kansas.

The Kansas Supreme Court has elevated the rights of royalty owners—rights derived solely from private contracts—to a higher level than the constitutional rights of Phillips. The Kansas courts have coupled the nationwide class action device with a distortion of controlling law to defeat Phillips' rights to have its obligations to royalty owners determined by interested states' laws. Phillips' constitutional rights were recognized by this Court's previous opinion in this action. Ensuring that both these safeguards for the nationwide class action and Phillips' constitutional rights are respected requires this Court once again to review and reverse the decision of the Kansas Supreme Court. Unless this Court takes this occasion to remind states of their constitutional obligations to defendants, state courts desirous of propagating and extending certain local policies will be emboldened to play fast and loose with the limits theoretically imposed on them by the obligations of federalism.

Ed Moore, formerly one of plaintiffs' counsel. That case was dismissed after Phillips sought to disqualify Moore as plaintiff class counsel. Moore immediately filed another Oklahoma class action on behalf of Robert and Betty Anderson. That case was dismissed after the trial court sustained a demurrer to the petition. Immediately thereafter, Robert and Betty Anderson joined with Irl Shutts as plaintiffs in this Kansas action. Moore represented the Andersons through the decision below, but subsequently has withdrawn.

CONCLUSION

For the foregoing reasons, the Petition of Phillips for a Writ of Mandamus or a Writ of Certiorari should be granted.

Respectfully submitted,

ARTHUR R. MILLER
1545 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4111

JOSEPH W. KENNEDY *
ROBERT W. COYKENDALL
MORRIS, LAING, EVANS, BROCK & KENNEDY, Chartered
Fourth Floor, 200 West Douglas
Wichita, Kansas 67202
(316) 262-2671

WILLIAM G. PAUL
JOHN L. WILLIFORD
T. L. CUBBAGE II
MICHAEL RIGGS
Phillips Petroleum Company
1256 Adams Building
Bartlesville, Oklahoma 74004
(918) 661-7026

Attorneys for Petitioner Phillips Petroleum Company

Date: October 6, 1987

* Counsel of Record